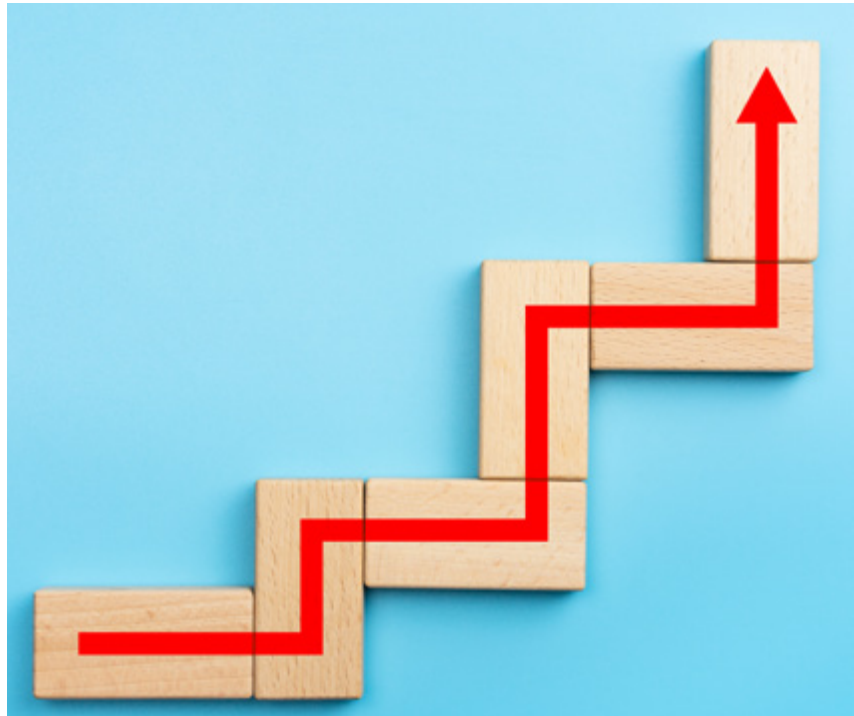


NEWS ALERT 27.03.20

# STEPS FOR LANDLORDS

## *as rental arrears grow*

**KRISTY DORNEY**Partner  
Real Estate and Commercial Disputes61 7 3239 2947  
kristy.dorney@mcmahonclarke.com

While this will not be a popular topic for some, unfortunately it is essential information for landlords right now.

As part of the Government's COVID-19 relief package, amendments to the insolvency laws, which commenced from Wednesday 25 March, will inevitably extend the time between financial distress for a business and the appointment of an independent professional to provide much needed financial and insolvency guidance.

Insolvency laws, particularly a director's liability for insolvent trading and the defence available if an external administrator is appointed early, are designed to incentivise directors to seek early professional and independent help when needed.

Under the control of an external administrator, the company is afforded breathing space so an informed judgment can be made as to whether the company can trade out or not. This includes protection from termination of leases and seizure of personal property needed to operate the business. The interests of unsecured creditors are protected during this time.

Delaying these appointments may irreparably compromise the ability of the business to trade out or propose an arrangement once the interim insolvency amendments are lifted.

While we await the announcement of the Government's rent relief package, partner Kristy Dorney provides some tips for landlords on steps they can take as rental collections begin to fall and tenants voluntarily close their doors.

### CLOSING DOORS

Ceasing to trade will only be a breach of a lease if the lease terms include an express obligation to operate the tenant's business during set hours, which is usually only found in retail leases.

Until the Government orders all workplaces to close and people to remain at home, the COVID-19 pandemic does not release a tenant from an obligation to remain open for trade. Social distancing directives are for all business owners to comply with, tenants and landlords included.

Some businesses will be a real drawcard to a centre, so closure

will have a measurable impact on the businesses of other tenants and overall trading of the centre. Also, it is not uncommon for retail leases to include provisions which allow the tenant additional rights where an anchor tenant ceases to trade, or where overall tenancy trading numbers fall below a set threshold. That means a tenant's decision to voluntarily close its doors will have serious knock-on implications for a landlord.

Landlords will need to respond to this on a case by case and centre by centre basis. Communications with tenants should address any additional security, health and safety issues that might need to be managed due to the closure. The response will often need to be rapid. Anecdotally, we have seen several situations where the tenant has simply given up and closed their doors before the landlord has had the opportunity to discuss how they can work with the tenant to keep the business operating.

### SHORT PAYMENT OF RENT

Some tenants have begun operating on a 'pay what you can' basis or unilaterally

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short paying rent without any discussion with their landlord. It is unlikely the pandemic will give rise to a right on the part of the tenant to abate its rent or recover a claim against the landlord from which it can set off rent. So, unilateral short payment of rent will be a breach of the lease terms. Many leases also require tenants to pay interest on late payments.

Landlords absolutely have a vested interest in assisting tenants to come out the other side of this pandemic. However, businesses are being impacted by the pandemic in different ways, Government relief packages are being released on a day to day basis with a view to assisting business to meet their obligations, including rent, and the landlord's own business needs to be sustained.

A tenant needs to have open and frank conversations with their landlord, providing financial information where requested, to support requests for rent relief. This allows the landlord to make informed decisions both in the short-term and once the full economic impact of this pandemic is known. Where a tenant has short paid rent without agreement or communication, we recommend the landlord engage with them in writing immediately, identifying the breach, and inviting the tenant to make contact to discuss it with a view to reaching a formal agreement if appropriate. The aim of the communication is to avoid any suggestion the landlord has accepted the short payment of rent, and even more so, to encourage important communication and disclosure so fact-based decisions can be made moving forward.

Although temporary measures are being put in place by the Government to slow down termination of leases and action for arrears, these are temporary measures and the accruing debt will ultimately have to be dealt with.

### **BANK GUARANTEES**

Subject to the terms of each lease, bank guarantees are likely to be available for a landlord to draw on to cover a rent shortfall. This will inevitably have some flow-on effect for the tenant with its bank. However, financial institutions are also offering relief which should soften that blow.

There has been no formal statement yet to indicate the Government intends to control a landlord's rights to call on bank guarantees.

### **ARREARS RECOVERY**

This is an inevitable but sensitive area.

As yet there are no proposed restrictions, yet, to prevent a landlord from issuing court proceedings to recover arrears owed. Rent and outgoings will accrue as a debt due and payable on a month to month basis. Where a landlord secures a court order then it can enforce this through methods such as garnishing wages or an application to seize and sell assets.

In practice though, the most common step taken to recover arrears is to put in process the steps necessary to have an insolvency practitioner appointed who will then take control of all assets and make the appropriate investigation for the benefit of all unsecured creditors.

The recent insolvency amendments (which apply from 25 March 2020) will significantly restrict the landlord from taking this action, increasing the threshold for a creditor's statutory demand from \$2,000 to \$20,000 and for bankruptcy notices, from \$5,000 to \$20,000 and allowing six months to comply with those notices in both occasions. This will apply to all debt, whether recent or long standing. Potentially, it may see landlords issuing notices now which they might not ordinarily issue at this stage given the long lead time.

### **TERMINATION OF LEASE**

Notices to remedy breach and lease termination rights under the lease continue to be available to landlords. However, restrictions are expected to be introduced across the States in the coming days.

New South Wales has already passed the COVID-19 Legislation Amendment (Emergency Measures) Bill (Bill) this week and it is understood other States will soon follow.

The Bill amends the Retail Leases Act in NSW to allow regulations to be made which will prohibit termination of leases and recovery of possession, limit enforcement of rights by lessors or owners of premises or land, and exempt tenants from the operation of a provision of an act or any agreement relating to the land.

Draft regulations have yet to be released, but they have the potential to significantly restrict landlords in dealing with defaulting tenants.

Separate to a landlord enforcing their own rights to terminate a lease, once the full impact of the pandemic and relief available is able to be understood, there will inevitably be a significant volume of agreements being reached with tenants involving the surrender of their lease.

### **WHAT ARE OTHER LANDLORDS DOING?**

The general sentiment from landlords continues to be that it is too early to know how to best fix this until we have an idea as to how long it will last and what other relief will be available.

Rent relief initiatives are starting to flow at a State level with payroll tax rebates and relief on offer, 10 year low interest Government loans for small businesses up to \$250,000 (with no repayments for the first year and interest only two years after that), and banks deferring loan repayments for small business loans for six months.

However, landlords are favouring short-term agreements to defer some rent with a view to further discussions once the full extent of the Government and financial institution relief pans out in the following days and weeks. Landlords are not rushing out to terminate leases or recover arrears. However, these steps may need to be taken particularly where a tenant was already substantially in default of their lease prior to the onset of the pandemic.

Where abatement is being offered, consideration is being given to reaching agreement to extend the lease term, exercise options early, add new rights or obligations in favour of the landlord and settling other claims on foot.

All tenants are asking for assistance; some who's businesses have been wholly destroyed by the mandated closures and some, still doing well, but preparing for what is inevitably to come. Where assistance is given, it is given on a case by case and as-needed basis.

Across the board, it is clear landlords are working cooperatively with their tenants to make the best of this very difficult situation. This includes reviewing trading hours and permitted uses to allow tenants to stay open while meeting the social distancing rules. In some cases, the tenant's financier is becoming directly involved in the conversation. Further, landlords should also consider their obligations to their own financier and investors.

### **WE CAN HELP**

Our Real Estate team can help step you through the options and explain the obligations for both landlords and tenants.